JOINT ECONOMIC COMMITTEE REPUBLICAN SENATE STAFF

Recent Economic Developments

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Vol. 1, No. 3 Sept. 10, 2002

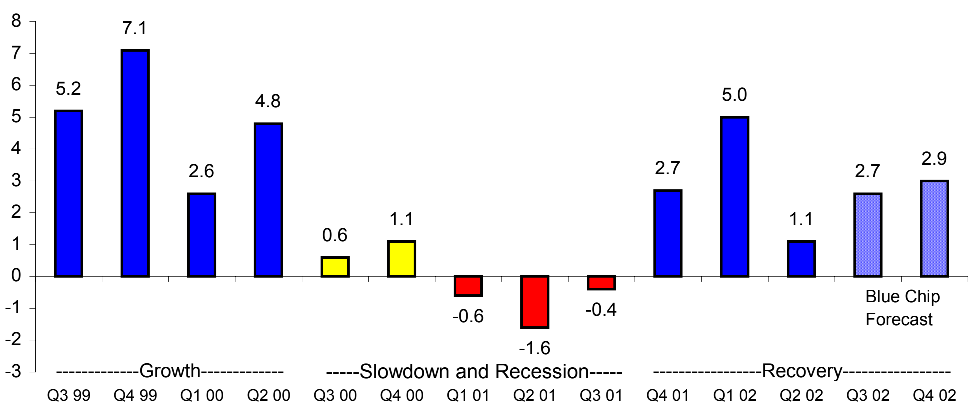
MODERATE GROWTH, NO DOUBLE-DIP

Three Lessons from Recent Data

- The economy has grown for three straight quarters, at an average annual rate of almost 3 percent.
- The economic slowdown began in mid-2000, well before the presidential election. The recovery began in the fourth quarter of 2001, despite the shock of terrorist attacks.
- Although the recovery weakened last quarter, forecasters see growth accelerating toward 3 percent by the end of the year, and averaging 3.5 percent in 2003. Forecasters do not foresee a "double-dip" return to recession.

Slowdown began in Q3 2000 - Recovery began in Q4 2001

Real GDP Growth (%, Annual Rate)



Source: Bureau of Economic Analysis, Blue Chip Economic Indicators (September)

Reasons for Optimism

- **Consumer Spending** continues to be strong, increasing one percent in July. Attractive financing and low mortgage rates continue to fuel auto and home sales. Existing home sales rose in July, after a June lull, and new home sales set a record. Auto sales, which have been strong all year, increased further over the summer.
- Key components of **Business Investment** have been strengthening. Investment in equipment and software increased at a 2.9 percent annual rate in the second quarter, following six quarters of decline. Businesses also began to rebuild inventories.
- **Industrial Activity** is on the rise. Durable goods orders jumped in July, shipments rose, and factory orders increased. Inventories remain low, pointing toward future

restocking. A key indicator of business investment — non-defense capital goods orders, excluding aircraft — climbed 8.8 percent in July.

Reasons for Caution

- Although **Employment** has grown for four straight months, that growth has been somewhat sluggish, which is not unusual for this stage of a recovery. 39,000 jobs were added in August, following a gain of 67,000 in July. Unemployment claims have been trending slightly upward, and layoffs have risen. However, the unemployment rate fell to 5.7 percent in August.
- **Non-Residential Construction** continues to decline; in the last year, it has fallen about 20 percent.
- **Personal Income** was unchanged in July, after two months of strong growth.
- **Retail Sales** have been sluggish since mid-July. Back-to-school sales were also reportedly slow, but picked up late in August.
- **Commercial Lenders** have been tightening standards for more than a year, but the pace of tightening has recently slowed. Lenders report weak demand for commercial and industrial loans. Corporate borrowing rates remain significantly above rates on Treasury securities, as lenders express a reduced tolerance for risk. Weakness in credit markets suggests investment may be slow to rebound.
- **Oil Prices** have risen, partly out of concern about developments in the Middle East.

Other Notable Developments

- **Stock Markets** continue to be highly volatile. Stocks rebounded by roughly 20 percent after their July 23 lows, but have since given up almost half of those gains.
- In early August, the **Federal Reserve** kept short-term interest rates unchanged, but expressed increased concern about future risks to growth. However, recent speeches by Fed officials suggest greater optimism. Financial markets do not expect a rate change at the Fed's September meeting, but they do project a chance of rate cuts later in the year.
- The **Trade Deficit** declined slightly in June, but remained large at $37.2 billion. A small increase in exports outpaced an even smaller increase in imports.